

meet the not-more-than-one-third support test under section 509(a)(2)(B) if it normally (within the meaning of paragraph (c), (d), or (e) of this section) receives not more than one-third of its support in each taxable year from the sum of its gross investment income (as defined in section 509(e)) and the excess (if any) of the amount of its unrelated business taxable income (as defined in section 512) derived from trades or businesses which were acquired by the organization after June 30, 1975, over the amount of tax imposed on such income by section 511. For purposes of this section the amount of support received from items described in section 509(a)(2)(B) will be referred to as the numerator of the not-more-than-one-third support fraction, and the total amount of support (as defined in section 509(d)) will be referred to as the denominator of the not-more-than-one-third support fraction. For purposes of section 509(a)(2), paragraph (m) of this section distinguishes gross receipts from gross investment income. For purposes of section 509(e), gross investment income includes the items of investment income described in § 1.512(b)-1(a).

(ii) *Trade or business.* For purposes of section 509(a)(2)(B)(ii), a trade or business acquired after June 30, 1975, by an organization shall include, in addition to other trades or businesses:

(A) A trade or business acquired after such date from, or as a result of the liquidation of, an organization's subsidiary which is described in section 502 whether or not the subsidiary was held on June 30, 1975.

(B) A new trade or business commenced by an organization after such date.

(iii) *Allocation of deductions between businesses acquired before, and businesses acquired after, June 30, 1975.* Deductions which are allowable under section 512 but are not directly connected to a particular trade or business, such as deductions referred to in paragraphs (10) and (12) of section 512(b), shall be allocated in the proportion that the unrelated trade or business taxable income derived from trades or businesses acquired after June 30, 1975, bears to the organization's total unrelated business taxable income, both amounts being

determined without regard to such deductions.

(iv) *Allocation of tax.* The tax imposed by section 511 shall be allocated in the same proportion as in paragraph (a)(3)(iii) of this section.

(4) *Purposes.* The one-third support test and the not-more-than-one-third support test are designed to insure that an organization which is excluded from private foundation status under section 509(a)(2) is responsive to the general public, rather than to the private interests of a limited number of donors or other persons.

(b) *Limitation on gross receipts—(1) General rule.* In computing the amount of support received from gross receipts under section 509(a)(2)(A)(ii) for purposes of the one-third support test of section 509(a)(2)(A), gross receipts from related activities received from any person, or from any bureau or similar agency of a governmental unit, are includible in any taxable year only to the extent that such receipts do not exceed the greater of \$5,000 or 1 percent of the organization's support in such taxable year.

(2) *Examples.* The application of this paragraph may be illustrated by the examples set forth below. For purposes of these examples, the term *general public* is defined as persons other than disqualified persons and other than persons from whom the foundation receives gross receipts in excess of the greater of \$5,000 or 1 percent of its support in any taxable year, and the term *gross receipts* is limited to receipts from activities which are not unrelated trade or business (within the meaning of section 513).

Example 1. For the taxable year 1970, X, an organization described in section 501(c)(3), received support of \$10,000 from the following sources:

Bureau M (a governmental bureau from which X received gross receipts for services rendered)	\$25,000
Bureau N (a governmental bureau from which X received gross receipts for services rendered)	25,000
General public (gross receipts for services rendered)	20,000
Gross investment income	15,000
Contributions from individual substantial contributors (defined as disqualified persons under section 4946(a)(2))	15,000
Total support	100,000

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Since the \$25,000 received from each bureau amounts to more than the greater of \$5,000 or 1 percent of X's support for 1970 (1% of \$100,000=\$1,000) under section 509(a)(2)(A)(ii), each amount is includible in the numerator of the one-third support fraction only to the extent of \$5,000. Thus, for the taxable year 1970, X received support from sources which are taken into account in meeting the one-third support test of section 509(a)(2)(A) computed as follows:

Bureau M	\$5,000
Bureau N	5,000
General public	20,000
Total	30,000

Therefore, in making the computations required under paragraph (c), (d), or (e) of this section, only \$30,000 is includible in the aggregate numerator and \$100,000 is includible in the aggregate denominator of the support fraction.

Example 2. For the taxable year 1970, Y, an organization described in section 501(c)(3), received support of \$600,000 from the following sources:

Bureau O (gross receipts for services rendered)	\$10,000
Bureau P (gross receipts for services rendered)	10,000
General public (gross receipts for services rendered)	150,000
General public (contributions)	40,000
Gross investment income	150,000
Contributions from substantial contributors	240,000
Total support	600,000

Since the \$10,000 received from each bureau amounts to more than the greater of \$5,000 or 1 percent of Y's support for 1970 (1% of \$600,000=\$6,000), each amount is includible in the numerator of the one-third support fraction only to the extent of \$6,000. Thus, for the taxable year 1970, Y received support from sources required to meet the one-third support test of section 509(a)(2)(A) computed as follows:

Bureau O	\$6,000
Bureau P	6,000
General public (gross receipts)	150,000
General public (contributions)	40,000
Total	202,000

Therefore, in making the computations required under paragraph (c), (d), or (e) of this section, \$202,000 is includible in the aggregate numerator and \$600,000 is includible in the aggregate denominator of the support fraction.

(c) *Normally—(1) In general—(i) Definition.* The support tests set forth in section 509(a)(2) are to be computed on the basis of the nature of the organization's *normal* sources of support. An organization will be considered as *normally* receiving one-third of its support

from any combination of gifts, grants, contributions, membership fees, and gross receipts from permitted sources (subject to the limitations described in paragraph (b) of this section) and not more than one-third of its support from items described in section 509(a)(2)(B) for its current taxable year and the taxable year immediately succeeding its current year, if, for the 4 taxable years immediately preceding the current taxable year, the aggregate amount of the support received during the applicable period from gifts, grants, contributions, membership fees, and gross receipts from permitted sources (subject to the limitations described in paragraph (b) of this section) is more than one-third, and the aggregate amount of the support received from items described in section 509(a)(2)(B) is not more than one-third of the total support of the organization for such 4-year period.

(ii) *Exception for material changes in sources of support.* If for the current taxable year there are substantial and material changes in an organization's sources of support other than changes arising from unusual grants excluded under subparagraph (3) of this paragraph, then in applying subdivision (i) of this subparagraph, neither the 4-year computation period, applicable to such year as an immediately succeeding taxable year, not the 4-year computation period, applicable to such year as a current taxable year shall apply, and in lieu of such computation periods there shall be applied a computation period consisting of the taxable year of substantial and material changes and the 4 taxable years immediately preceding such year. Thus, for example, if there are substantial and material changes in an organization's sources of support for taxable year 1976, then even though such organization meets the requirements of subdivision (i) of this subparagraph based on a computation period of taxable years 1971 through 1974 or 1972 through 1975, such an organization will not meet the requirements of section 509(a)(2) unless it meets the requirements of subdivision (i) of this subparagraph for a computation period of the taxable years 1972 through 1976. See example 3 in subparagraph (6) of this paragraph for an

illustration of this subdivision. An example of a substantial and material change is the receipt of an unusually large contribution or bequest which does not qualify as an unusual grant under subparagraph (3) of this paragraph. See subparagraph (5)(ii) of this paragraph as to the procedure for obtaining a ruling whether an unusually large grant may be excluded as an unusual grant.

(iii) *Status of grantors and contributors.* (a) If as a result of subdivision (ii) of this subparagraph, an organization is not able to meet the requirements of either the one-third support test described in paragraph (a)(2) of this section or the not-more-than-one-third support test described in paragraph (a)(3) of this section for its current taxable year, its status (with respect to a grantor or contributor under sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522) will not be affected until notice of change of status under section 509(a)(2) is made to the public (such as by publication in the Internal Revenue Bulletin). The preceding sentence shall not apply, however, if the grantor or contributor was responsible for, or was aware of, the substantial and material change referred to in subdivision (ii) of this subparagraph, or acquired knowledge that the Internal Revenue Service had given notice to such organization that it would be deleted from classification as section 509(a)(2) organization.

(b) A grantor or contributor other than one of the organization's founders, creators, or foundation managers (within the meaning of section 4946(b)) will not be considered to be responsible for, or aware of, the substantial and material change referred to in subdivision (ii) of this subparagraph if such grantor or contributor has made such grant or contribution in reliance upon a written statement by the grantee organization that such grant or contribution will not result in the loss of such organization's classification as not a private foundation under section 509(a). Such statement must be signed by a responsible officer of the grantee organization and must set forth sufficient information, including a summary of the pertinent financial data for the 4 preceding years, to assure a reasonably

prudent man that his grant or contribution will not result in the loss of the grantee organization's classification as not a private foundation under section 509(a). If a reasonable doubt exists as to the effect of such grant or contribution, or if the grantor or contributor is one of the organization's founders, creators, or foundation managers, the procedure set forth in subparagraph (5)(ii) of this paragraph may be followed by the grantee organization for the protection of the grantor or contributor.

(iv) *Special rule for new organizations.* If an organization has been in existence for at least 1 taxable year consisting of at least 8 months, but for fewer than 5 taxable years, the number of years for which the organization has been in existence immediately preceding each current taxable year being tested will be substituted for the 4-year period described in subdivision (i) of this subparagraph to determine whether the organization *normally* meets the requirements of paragraph (a) of this section. However, if subdivision (ii) of this subparagraph applies, then the period consisting of the number of years for which the organization has been in existence (up to and including the current year) will be substituted for the 4-year period described in subdivision (i) of this subparagraph. An organization which has been in existence for at least 1 taxable year, consisting of 8 or more months, may be issued a ruling or determination letter if it *normally* meets the requirements of paragraph (a) of this section for the number of years described in this subdivision. Such an organization may apply for a ruling or determination letter under the provisions of this paragraph, rather than under the provisions of paragraph (d) of this section. The issuance of a ruling or determination letter will be discretionary with the Commissioner. See paragraph (e)(4) of this section as to the initial determination of the status of a newly created organization. This subdivision shall not apply to those organizations receiving an extended advance ruling under paragraph (d)(4) of this section.

(2) *Terminations under section 507(b)(1)(B).* For the special rules applicable to the term *normally* as applied to

private foundations which elect to terminate their private foundation status pursuant to the 12-month or 60-month procedure provided in section 507(b)(1)(B), see the regulations under such section.

(3) *Exclusion of unusual grants.* For purposes of applying the 4-year aggregation test for support set forth in subparagraph (1) of this paragraph, one or more contributions (including contributions made prior to Jan. 1, 1970) may be excluded from the numerator of the one-third support fraction and from the denominator of both the one-third support and not-more-than-one-third support fractions only if such a contribution meets the requirements of this subparagraph. The exclusion provided by this subparagraph is generally intended to apply to substantial contributions and bequests from disinterested parties, which contributions or bequests:

(i) Are attracted by reason of the publicly supported nature of the organization;

(ii) Are unusual or unexpected with respect to the amount thereof; and

(iii) Would by reason of their size, adversely affect the status of the organization as normally meeting the one-third support test for any of the applicable periods described in paragraph (c), (d), or (e) of this section.

In the case of a grant (as defined in paragraph (g) of this section) which meets the requirements of this subparagraph, if the terms of the granting instrument (whether executed before or after 1969) require that the funds be paid to the recipient organization over a period of years, the amount received by the organization each year pursuant to the terms of such grant may be excluded for such year. However, no item described in section 509(a)(2)(B) may be excluded under this subparagraph. The provisions of this subparagraph shall apply to exclude unusual grants made during any of the applicable periods described in paragraph (c), (d), or (e) of this section. See subparagraph (5)(ii) of this paragraph as to reliance by a grantee organization upon an unusual grant ruling under this subparagraph.

(4) *Determining factor.* In determining whether a particular contribution may be excluded under subparagraph (3) of

this paragraph, all pertinent facts and circumstances will be taken into consideration. No single factor will necessarily be determinative. Among the factors to be considered are:

(i) Whether the contribution was made by any person (or persons standing in a relationship to such person which is described in section 4946(a)(1)(C) through (G)) who created the organization, previously contributed a substantial part of its support or endowment, or stood in a position of authority, such as a foundation manager (within the meaning of section 4946(b)), with respect to the organization. A contribution made by a person other than those persons described in this subdivision will ordinarily be given more favorable consideration than a contribution made by a person described in this subdivision.

(ii) Whether the contribution was a bequest or an inter vivos transfer. A bequest will ordinarily be given more favorable consideration than an inter vivos transfer.

(iii) Whether the contribution was in the form of cash, readily marketable securities, or assets which further the exempt purposes of the organization, such as a gift of a painting to a museum.

(iv) Except in the case of a new organization, whether, prior to the receipt of the particular contribution, the organization (a) has carried on an actual program of public solicitation and exempt activities and (b) has been able to attract a significant amount of public support.

(v) Whether the organization may reasonably be expected to attract a significant amount of public support subsequent to the particular contribution. In this connection, continued reliance on unusual grants to fund an organization's current operating expenses (as opposed to providing new endowment funds) may be evidence that the organization cannot reasonably be expected to attract future support from the general public.

(vi) Whether, prior to the year in which the particular contribution was received, the organization met the one-third support test described in subparagraph (1) of this paragraph without the benefit of any exclusions of unusual

grants pursuant to subparagraph (3) of this paragraph;

(vii) Whether neither the contributor nor any person standing in a relationship to such contributor which is described in section 4946(a)(1) (C) through (G) continues directly or indirectly to exercise control over the organization;

(viii) Whether the organization has a representative governing body as described in § 1.509(a)-3(d)(3)(i); and

(ix) Whether material restrictions or conditions (within the meaning of § 1.507-2(a)(8)) have been imposed by the transferor upon the transferee in connection with such transfer.

(5) *Grantors and contributors.* (i) As to the status of grants and contributions which result in substantial and material changes in the organization (as described in subparagraph (1)(ii) of this paragraph) and which fail to meet the requirements for exclusion under subparagraph (3) of this paragraph, see the rules prescribed in subparagraph (1)(iii) of this paragraph.

(ii) Prior to the making of any grant or contribution which will allegedly meet the requirements for exclusion under subparagraph (3) of this paragraph, a potential grantee organization may request a ruling whether such grant or contribution may be so excluded. Requests for such ruling may be filed by the grantee organization with the district director. The issuance of such ruling will be at the sole discretion of the Commissioner. The organization must submit all information necessary to make a determination of the applicability of subparagraph (3) of this paragraph, including all information relating to the factors described in subparagraph (4) of this paragraph. If a favorable ruling is issued, such ruling may be relied upon by the grantor or contributor of the particular contribution in question for purposes of sections 170, 507, 545(b)(2), 556(b)(2), 642(c), 4942, 4945, 2055, 2106(a)(2), and 2522 and by the grantee organization for purposes of subparagraph (3) of this paragraph.

(6) *Examples.* The application of the principles set forth in this paragraph is illustrated by the examples set forth below. For purposes of these examples, the term *general public* is defined as persons other than disqualified persons

and other than persons from whom the foundation received gross receipts in excess of the greater of \$5,000 or 1 percent of its support in any taxable year, the term *gross investment income* is as defined in section 509(e), and the term *gross receipts* is limited to receipts from activities which are not unrelated trade or business (within the meaning of section 513).

Example 1. For the years 1970 through 1973, X, an organization exempt under section 501(c)(3) which makes scholarship grants to needy students of a particular city, received support from the following sources:

1970	
Gross receipts (general public)	\$35,000
Contributions (substantial contributors)	36,000
Gross investment income	29,000
Total support	100,000
1971	
Gross receipts (general public)	34,000
Contributions (substantial contributors)	35,000
Gross investment income	31,000
Total support	100,000
1972	
Gross receipts (general public)	35,000
Contributions (substantial contributors)	30,000
Gross investment income	35,000
Total support	100,000
1973	
Gross receipts (general public)	30,000
Contributions (substantial contributors)	39,000
Gross investment income	31,000
Total support	100,000

In applying section 509(a)(2) to the taxable year 1974 on the basis of subparagraph (1)(i) of this paragraph, the total amount of support from gross receipts from the general public (\$134,000) for the period 1970 through 1973 was more than one-third, and the total amount of support from gross investment income (\$126,000) was less than one-third, of its total support for the same period (\$400,000). For the taxable years 1974 and 1975, X is therefore considered *normally* to receive more than one-third of its support from the public sources described in section 509(a)(2)(A) and less than one-third of its support from items described in section 509(a)(2)(B) since due to the pattern of X's support, there are no substantial and material changes in the sources of the organization's support in these years. The fact that X received less than one-third of its support from section 509(a)(2)(A) sources in 1973 and more than one-third of its support from items described in section 509(a)(2)(B) in 1972 does not affect its status since it met the *normally* test over a 4-year period.

Example 2. Assume the same facts as in example 1 except that in 1973 X also received an unexpected bequest of \$50,000 from A, an

elderly widow who was interested in encouraging the work of X, but had no other relationship to it. Solely by reason of the bequest, A became a disqualified person. X used the bequest to create five new scholarships. Its operations otherwise remained the same. Under these circumstances X could not meet the 4-year support test since the total amount received from gross receipts from the general public (\$134,000) would not be more than one-third of its total support for the 4-year period (\$450,000). Since A is a disqualified person, her bequest cannot be included in the numerator of the one-third support test under section 509(a)(2)(A). However, based on the factors set forth in subparagraph (4) of this paragraph, A's bequest may be excluded as an unusual grant under subparagraph (3) of this paragraph. Therefore, X will be considered to have met the support test for the taxable years 1974 and 1975.

Example 3. In 1970, Y, an organization described in section 501(c)(3), was created by A, the holder of all the common stock in M corporation, B, A's wife, and C, A's business associate. Each of the three creators made small cash contributions to Y to enable it to begin operations. The purpose of Y was to sponsor and equip athletic teams for underprivileged children in the community. Between 1970 and 1973, Y was able to raise small amounts of contributions through fund raising drives and selling admission to some of the sponsored sporting events. For its first year of operations, it was determined that Y was excluded from the definition of *private foundation* under the provisions of section 509(a)(2). A made small contributions to Y from time to time. At all times, the operations of Y were carried out on a small scale, usually being restricted to the sponsorship of two to four baseball teams of underprivileged children. In 1974, M recapitalized and created a first and second class of 6 percent nonvoting preferred stock, most of which was held by A and B. A then contributed 49 percent of his common stock in M to Y. A, B, and C continued to be active participants in the affairs of Y from its creation through 1974. A's contribution of M's common stock was substantial and constituted 90 percent of Y's total support for 1974. Although Y could satisfy the one-third support test on the basis of the four taxable years prior to 1974, a combination of the facts and circumstances described in subparagraph (4) of this paragraph preclude A's contribution of M's common stock in 1974 from being excluded as an unusual grant under subparagraph (3) of this paragraph. A's contribution in 1974 constituted a substantial and material change in Y's sources of support within the meaning of subparagraph (1)(ii) of this paragraph and on the basis of the 5-year period prescribed in subparagraph (1)(ii) of this paragraph (1970 to 1974), Y would not be considered as *normally* meeting the one-third

support test described in paragraph (a)(2) of this section for the taxable years 1974 (the current taxable year) and 1975 (the immediately succeeding taxable year).

Example 4. M, an organization described in section 501(c)(3), was organized in 1971 to promote the appreciation of ballet in a particular region of the United States. Its principal activities will consist of erecting a theater for the performance of ballet and the organization and operation of a ballet company. The governing body of M consists of 9 prominent unrelated citizens residing in the region who have either an expertise in ballet or a strong interest in encouraging appreciation of the art form. In order to provide sufficient capital for M to commence its activities, X, a private foundation, makes a grant of \$500,000 in cash to M. Although A, the creator of X, is one of the nine members of M's governing body, was one of M's original founders, and continues to lend his prestige to M's activities and fund raising efforts, A does not, directly or indirectly, exercise any control over M. By the close of its first taxable year, M has also received a significant amount of support from a number of smaller contributions and pledges from other members of the general public. Upon the opening of its first season of ballet performances, M expects to charge admission to the general public. Under the above circumstances, the grant by X to M may be excluded as an unusual grant under subparagraph (3) of this paragraph for purposes of determining whether M meets the one-third support test under section 509(a)(2). Although A was a founder and member of the governing body of M, X's grant may be excluded.

Example 5. Assume the same facts as Example 4. In 1974, during M's third season of operations, B, a widow, passed away and bequeathed \$4 million to M. During 1971 through 1973, B had made small contributions to M, none exceeding \$10,000 in any year. During 1971 through 1974, M had received approximately \$550,000 from receipts for admissions and contributions from the general public. At the time of B's death, no person standing in a relationship to B described in section 4946(a)(1) (C) through (G) was a member of M's governing body. B's bequest was in the form of cash and readily marketable securities. The only condition placed upon the bequest was that it be used by M to advance the art of ballet. Under the above circumstances, the bequest of B to M may be excluded as an unusual grant under subparagraph (3) of this paragraph for purposes of determining whether M meets the one-third support test under section 509(a)(2).

Example 6. O is a research organization described in section 501(c)(3). O was created by A in 1971 for the purpose of carrying on economic studies primarily through persons receiving grants from O and engaging in the